

**BARNES & NOBLE COMMENTS TO FEDERAL TRADE COMMISSION AND
U.S. DEPARTMENT OF JUSTICE CONCERNING PATENT LITIGATION**

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INTRODUCTION

The patent system is broken. Barnes & Noble alone has been sued by “non practicing entities”—a/k/a patent trolls—well over twenty-five times and received an additional twenty-plus patent claims in the last five years. The claimants do not have products and are not competitors. They assert claims for the sole purpose of extorting money. Companies like Barnes & Noble have to choose between paying extortionate ransoms and settling the claim, or fighting in a judicial system ill equipped to handle baseless patent claims at costs that frequently reach millions of dollars.

BACKGROUND

Barnes & Noble is a Fortune 500 company and leading retailer of content, digital media, and educational products. The company operates 677 Barnes & Noble bookstores in 50 states, and one of the Web’s largest e-commerce sites, BN.com (www.bn.com). The NOOK digital business offers award-winning NOOK[®] products and an expansive collection of digital reading and entertainment content through the NOOK Store[™] (www.nook.com). In addition, Barnes & Noble College Booksellers, LLC operates 678 bookstores serving over 4.6 million students and faculty members at colleges and universities across the United States.

As a retail and technology leader, Barnes & Noble has a dual interest in preserving and rewarding innovation while fixing the untenable burden to business—and ultimately, to downstream consumers and society—that patent trolls impose. We offer solutions that will work and respectfully submit these comments for consideration by the Federal Trade Commission and U.S. Department of Justice.

ANALYSIS

The Current System is Broken

In the current system, patent trolls overwhelm operating companies with baseless litigation that is extremely costly to defend. Patent cases generally cost at least \$2M to take through trial, and frequently much more. Litigating, even to victory, also entails massive business disruption. Companies are forced to disclose their most sensitive and top-secret technical and financial information and must divert key personnel from critical business tasks to provide information and testimony. The process is exceptionally burdensome, especially on technical staff. Document discovery and depositions seem endless.

Patent trolls know this and as a result, they sue companies in droves and make settlement demands designed to maximize their financial take while making it cheaper and less painful to settle than to devote the resources necessary to defeat their claims. The current system lets them do so even with claims that are unlikely to prevail on the merits. That is because, whether win lose or draw, the rules effectively insulate trolls from negative consequences except perhaps a lower return than expected from any given company in any given case. They can sue on tenuous claims and still come out ahead. And so the broken system with its attendant leverage allows trolls to extract billions in blackmail from U.S. companies and, in the final analysis, consumers.

The AIA Did Not Fix the Troll Problem

In September 2011, President Obama signed the America Invents Act (“AIA”). Though touted as “overhauling” the patent system, with respect to the nation’s troll problem the AIA was not reform in any meaningful sense. Anyone who says otherwise is

almost surely a patent lawyer or member of another group with a vested financial interest in preserving the status quo. Those groups successfully watered down the AIA to keep entrenched a system that continues to allow trolls to benefit unfairly, while businesses and society pay the high price in the form of major, unnecessary, and extremely burdensome costs.

The Constitution Requires a Change

Something must change. Common sense and the elimination of this blight on the economy are not the only reasons why. There is also a constitutional basis.

The Patent and Copyright Clause grants Congress the power “[t]o...promote the Progress of *Science and useful Arts*,” not science fiction and litigious arts. (Article 1, Section 8, Clause 8 (emphasis added)). But the current system allows trolls to pursue fantastic allegations—claims that would be laughed out of the room in actual scientific or technical circles—in endless litigation that taxes and taxes true innovators while making no meaningful contribution to society. Barnes & Noble’s experience exemplifies this and industry data confirms it. *See, e.g.*, James Bessen & Michael J. Meurer, “The Direct Costs from NPE Disputes” at 2, Boston Univ. School of Law Working Paper No. 12–34 (June 28, 2012) (available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091210) (estimating direct costs of troll litigation on economy at \$29 billion for 2011 based upon study that included data from 82 companies and finding additional empirical support for earlier conclusion that “much of the cost borne by technology companies as they defend against NPE lawsuits is a social loss and not a mere transfer”). The system has lost its true north.

Barnes & Noble's Experience Exemplifies the Problem

Barnes & Noble is uniquely positioned to expose the drain imposed by patent troll litigation and suggest solutions to achieve a material reduction. The company is currently adverse to patent trolls in nineteen cases.¹ We have spent tens of millions of dollars in the last five years to defend against these suits. Yet Barnes & Noble has never received an adverse judgment in patent litigation.

These facts are possible only because the patent troll litigation Barnes & Noble faces is devoid of merit, but exposing that in the present system takes years, is very expensive, and is fraught with business disruption and risk. This causes Barnes & Noble to face dilemmas that no company should have to face once let alone repeatedly: spend millions and divert resources away from the business to defeat baseless claims in litigation or be mistaken for an easy mark; pay the ransom because the exorbitant demand is less than the enormous cost of defense.

Even the most plainly baseless lawsuits are expensive and can take years to defeat. In at least four cases, Barnes & Noble has faced litigation by patentees asserting the same theories on which they previously lost. In one case, for example, Barnes & Noble is alleged to infringe patents because BN.com uses the HTML language and returns search results other than exact matches. The patentee asserted these allegations against Barnes & Noble despite having tried and lost a case against other ecommerce retailers based on the same functional allegations levied against their websites. In two of these four cases, the patentees ceased pursuing claims against Barnes & Noble once the

¹ The number rises to twenty-one when “practicing entity trolls” or PETs—operating companies that enforce patents against non-competitors who commercialize technology they do not—are counted.

United States Court of Appeals for the Federal Circuit affirmed their earlier losses. But in two others, the appeals are not yet final and although Barnes & Noble has filed dispositive motions, the litigations have carried on actively for years.

In two other recent cases, Barnes & Noble achieved victory at the district court level on summary judgment. In one such case, the Court awarded Barnes & Noble its costs—but the total awarded was less than \$50K. The company expended millions to achieve that victory, but attorneys' and expert fees are not recoverable as a matter of course.

Appeals routinely follow summary judgment victories, and Barnes & Noble's experience has been no exception. The Federal Circuit now has a mandatory mediation program. In that program, Barnes & Noble has received demands for substantial settlement payments—even in cases that it won below. One such demand, for example, exceeded \$3M. The settlement demands that patent trolls make on appeal, particularly in the wake of complete defeat, have nothing to do with the merits. They underscore the uncertainty and expense that accompany appeals and potential retrials in patent cases.

In a growing number of cases, patentees sue Barnes & Noble on multiple patents only to drop one or more of them before trial. This practice underscores that many patent claims are not made in good faith. Rather, plaintiffs frequently assert patents for additional leverage to force companies to expend significant resources mounting a defense on multiple fronts even when they know they will not ultimately prevail.

Barnes & Noble and other technology companies see countless lawsuits in which the asserted patents purport to cover products and technologies common to the entire industry. We face repeated allegations that anyone using Wi-Fi, anyone using 3G,

anyone using MP3, anyone with an e-commerce website, anyone using Ethernet, and, recently, anyone using InfiniBand technology, to name a few, is infringing and must pay a hefty price to license purportedly essential patents. The allegations sweep far beyond specific innovations to which a patent might legitimately lay claim.

What is more, the damages claims are grossly overblown. The costs of the components that implement the accused technology in NOOK devices are frequently a few dollars or less. Notwithstanding limited positive evolution in the damages case law, patent trolls continue to seek damages that far exceed those component costs even though the patent is worth at most a fraction of those costs. They invoke the outmoded *Georgia-Pacific* factors to pursue theories that have no valid economic basis claiming, for example, that a patent that purportedly improved some particular aspect of display technology or Wi-Fi entitles the assignee to a cut of all eContent sales made through Barnes & Noble's NOOK devices. They wield the fruits of their prior extortion as swords, claiming that because others paid dearly to resolve or avoid litigation, the resulting settlement agreements are reliable evidence of a patent's value.

Certain courts have started more reliably to preclude nonsensically overblown damages claims at trial. This does not seem to be happening uniformly in all jurisdictions or before all judges in any given jurisdiction, though. Therefore the threat of an excessive damages award remains present.

It is also still far too rare for courts to impose realistic bounds in the discovery process. They frequently permit discovery of extremely sensitive financial information even when governing Federal Circuit law renders the information irrelevant. Most district courts also do not bifurcate damages discovery, and therefore companies must

produce their most sensitive information even when the likelihood that they infringe a patent is extremely low.

Patent trolls have started suing Barnes & Noble in the International Trade Commission. After the Supreme Court's 2006 decision in *eBay v. MercExchange*² appropriately made it virtually impossible for non-commercializing patentees to obtain an injunction, patent trolls began initiating ITC investigations because the agency has the power to issue exclusion orders barring the importation of products found to infringe a patent. But the ITC is not supposed to be a general intellectual property protection agency. It only has the power to protect a domestic industry for products protected by intellectual property. Even though its mandate is to protect *trade*, not patent trolls, the ITC and Federal Circuit have interpreted the agency's jurisdiction too broadly, finding the requisite domestic industry based on patent licensing efforts alone.

FIVE SOLUTIONS THAT WILL WORK

1. Require Losing Patentees to Pay Costs and Expenses, Including Attorneys' Fees

A main reason the problem runs rampant is that patent trolls face virtually no downside. Although there are rules permitting parties to seek sanctions and recover attorneys' fees, such awards are limited to the most egregious cases. Fee shifting tends to require litigation misconduct, not merely the pursuit of a weak case. This should change.

The bar for fee shifting should be much lower so that anyone initiating patent litigation would have to face the prospect of a genuine downside from choosing to pursue weak claims. Requiring plaintiffs that do not prevail to pay defense costs including

547 U.S. 388 (2006).

attorneys' fees in patent cases would substantially reduce questionable litigation by appropriately aligning incentives to discourage it. This change would cause trolls to think twice before proceeding with questionable claims.

Fee shifting should be also available to defendants where patentees initially assert but then drop patents mid-stream. The current system imposes no penalty for such gamesmanship. Fee shifting would deter the assertion of weak patent claims made simply to drive up defense costs.

2. Require Actual Reduction to Practice and Commercialization

Many trolls litigate on paper patents—supposed inventions for which a working prototype was never built, let alone a commercial implementation. This invites arguments that the putative invention sweeps more broadly than anything the named inventor ever actually created. The alleged invention becomes a moving target. What was in actuality at best a minor improvement gets spun as a foundational patent for which an entire industry is taxed. This should change.

Strengthening standing requirements would be a step in the right direction. Standing to initiate litigation should require a patentee to have actually reduced the invention to practice and begun commercializing it. That would help ensure the existence of a real invention before others are excluded from commercializing their independent contributions, and it would help limit the scope of patent rights to what was actually invented and contributed to society in a meaningful way.

3. Cap Damages at the Amount Paid to Acquire a Patent

Most patent trolls are not small inventors. Rather, they are typically small companies held closely by lawyers or other investors, which acquired the patents they

assert through arms-length transactions. In the current system, patent acquisition by trolls frequently entails the payment of comparatively minor amounts to small inventors. The acquirers then use their resources in addition to the patents to extract huge sums from technology companies in litigation. There is a tremendous disconnect between what a patent is worth to an acquiring entity when dealing with a small inventor and what it becomes worth to that entity in subsequent litigation. This should change.

There is no reason a non-commercializing entity should be able to recover in litigation damages beyond what the entity paid to acquire the entire patent. Provided the acquisition was accomplished in an arms-length transaction, the purchase price should serve as a cap to any subsequent damages award.

4. Require Clear and Convincing Proof that an Invention is New and Non-obvious for a Patent to Issue

In the current system, patent examiners issue patents if they conclude that an invention is new and non-obvious in light of the prior art. From that point forward, the patent enjoys a presumption of validity even though time and resource constraints mean that the prior art picture before an examiner is necessarily incomplete. Once a patent issues, a challenger accused of infringement can be found to infringe based upon a preponderance of the evidence but must prove invalidity by clear and convincing evidence.

Whether or not the standard for proving invalidity should change—the Supreme Court declined to alter it in 2011 in *Microsoft v. i4i*—this same level of clear and convincing proof should be required to issue a patent in the first instance. The Patent Office would issue fewer patents that are not truly new and nonobvious if examiners had

to be satisfied by clear and convincing evidence. Real inventions worthy of the “embarrassment of an exclusive patent”³ should have no problem satisfying that standard.

5. Keep Trolls Out of the ITC

ITC exclusion orders have become available to entities that have contributed nothing meaningful to society or the economy. The ITC should be off limits to anyone asserting a patent it is failing to commercialize. Nor should licensing efforts alone suffice to establish the requisite domestic industry for that special forum, which should be protecting companies from unfair trade practices, not fostering them.

³ Letter from Thomas Jefferson to Isaac McPherson (Aug. 13, 1813).

CONCLUSION

Barnes & Noble respectfully asks the Federal Trade Commission and U.S. Department of Justice to take prompt action to solve the patent troll litigation problem. Thank you for your consideration of these comments.

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Respectfully submitted,

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